

Graham, Benjamin & Dodd, David - Security Analysis

McGraw-Hill, (6th edition) 2009, [Equity Investing] Grade ★★★★★

This is probably the most famous book of all books in the investment arena, quoted as one of the most important books by several investment legends like Warren Buffet. Buffett who had Graham as a teacher, and who was his favourite student earning the highest grade was the only one to have been given an A+. After he graduated Buffett went on to work for Graham's fund.

The first edition was written in 1934, at the depth of the depression, which inspired Graham to search for a more conservative, safer way to invest. Graham agreed to teach at Columbia University with the stipulation that someone took notes. Dodd, then a young instructor at Columbia, volunteered. Those transcripts served as the basis for this book that "created" the concept of value investing. The second edition is a slight update, and considered by many to be the best. However, it's over 70 years old, and personally I have always felt it rather dated and there are numerous other more modern value investing books that are easier to relate to. That's why when this book, the 6th edition, arrived in 2009 I jumped with joy since almost everyone who is anyone in the value investing arena has contributed personally. Warren Buffett has written the foreword, Seth Klarman is the editor writing an excellent preface, and finally James Grant writes an intriguing introduction. Then follow comments from various famous people, putting Graham's theories into a current setting.

The book has eight parts, and the mission is *Security Analysis*, securities meaning stocks, bonds and variations of that. Roughly half of the book deals with stocks, and the other bonds etc. I think it's enough to read part 1 – the essential lessons and part 5 – analysis of the income statement, if you are focused on stocks. The rest is either not equity related or too detailed and frankly sometimes boring. However the introduction to each chapter by current superstars is an easy must read. They give an up to date view on each part, its relevance

today, where they agree and disagree, and how they use it in their current business. I would highlight Howard Marks text on bonds, Bruce Berkowitz who writes about stock dividends, and finally Bruce Greenwald who writes about the balance sheet and implications on valuation.

There is a wealth of timeless advice in the book, to me the following are among the simplest and most practical ideas Graham has. With regard to timing: *"It is our view that stock market timing cannot be done unless the time to buy is related to an attractive price level, as measured by analytical standards."* He went further suggesting that *"the investor should calculate a normalised earnings number, based upon the history, last 5-10 years, and a conservative estimate on the future."*

Everyone is a product of the time that we live in. Clearly Mr Graham was no exception. He was born in 1894 and his family was ruined in the crash of 1907. He graduated from Columbia 1914, worked as an analyst, followed by starting an investment firm (Graham & Newman) in 1926. His work before the crash indicates that he was a conservative investor already before the market crash 1929, but the depth of it clearly also took him by surprise. He lost a lot of the money and some even suggest he was ruined. Jason Zweig, the editor of the second edition, says he lost 70% 1929-1932. From then his Graham-Newman corp had 14.7% annual return 1936-1956, vs market 12.2%, it was a fund closed to outside investors, (pre 2/20 fees it was >20% per annum). But as he grew older he changed his mind a bit. In the 70s he stopped advocating a use of the techniques described in his text in selecting individual stocks, citing the extensive efforts and costs required to generate superior returns in a modern efficient market. His way of finding bargains became more difficult, but this wasn't a problem for his A+ student. Warren Buffett quickly adopted reading one more book, Philip Fishers, Common Stocks and Uncommon Profits. The result is investment history.

Bo Börtemark, April 11, 2012